United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

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74-2306

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FOR THE SECOND CIRCUIT

Docket No. 74-2306

IN THE MATTER
of
FAS INTERNATIONAL, INC.,
Debtor.

UNITED STATES TRUST COMPANY OF NEW YORK,
Successor Indenture Trustee-Appellant,
FAS INTERNATIONAL, INC.,
Debtor-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF APPELLANT

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For the Southern District of New York

REPLY BRIEF OF APPELLANT

This Reply Brief is submitted on behalf of the Appellant, United States Trust Company of New York, as Successor Indenture Trustee (the "Indenture Trustee"), in support of its application for allowance of compensation for services performed by its counsel and in reply to the Brief of the Appellee FAS International, Inc. filed in opposition to such application.

Before addressing the arguments raised by Appellee, we must note certain serious errors in its "Statement of The Case" appearing on pages 2 and 3 of its brief.

Appellee first states that no ambiguity existed in the language of the Trust Indenture with respect to the subordination of the debt owing to the public debentureholders. If this were true, no valid reason exists why the Appellee gave 20% of its shares to the subordinated debentureholders since senior debt was not being paid in full.

Appellee's contention that the Bankruptcy Court's ruling that the Indenture Trustee could vote only one claim gave the public debentureholders a voice in the proceeding, and indeed a power of veto, is misleading. The fact is that unsecured creditors who actually appeared in person or by proxy at the election of the tentative trustee at the first meeting of creditors outnumbered *in amount* the entire debenture issue. The public debentureholders had a majority *in number* at the election, and the Bankruptcy Court's ruling that the Indenture Trustee could vote only one claim therefore disenfranchised the debentureholders. Consequently the Indenture Trustee not only had no veto power but no say at all in the proceedings.

Appellee further errs by stating that the bankruptcy Court designated the Debentureholders a separate class. Appellee designated the Debentureholders a separate class in its Plan after lengthy negotiations.

With respect to Appellee's denial of the oral agreement not to object to the application of the Indenture Trustee and its counsel for allowances, the record is clear that no objections were made either by Appellee or the Official Creditors Committee until the Bankruptcy Court directed Appellee to defend the appeal to the District Court. See Appendix pp. 30-31.

We turn now to Appellee's arguments.

First, it is of interest to note that counsel for the Appellee admits that it took the position in the Bankruptcy Court, and still takes the position, that the public debentureholders

were subordinated to the other principal creditors and hence were entitled to no consideration in the negotiation of or under the terms of the Plan of Arrangement. Appellee will not even concede that there was any valid question raised "with respect to the scope and extent of the subordination" and admits that they were "forced" to pay attention to the debentureholders only because of the efforts of counsel for the Successor Indenture Trustee (Brief, p. 2). This is a clear (though perhaps inadvertent) endorsement of the value of the services performed by counsel for the Indenture Trustee and an admission that without the presence of counsel for the Indenture Trustee the debentureholders would have been excluded from the Plan of Arrangement.

Appellee sees no inconsistency between the disregard of the debentureholders' interests by the Official Committee and the repeated references in Appellee's brief to so-called Congressional intent and "statutory policy" of "assuring that [the official] Committee will be representative of all unsecured creditors" (Appellee's Brief p. 14).* Overlooked by Appellee is the fact that the Congressional concern that the Official Committee adequately represent all unsecured creditors applies especially to public security-holders, including just such a body of debentureholders as was represented in this proceeding by the Indenture Trustee alone. Congressional intent, therefore, to the extent

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* See also the statement on page 13 of Appellee's brief:

> "The amendments [to the Bankruptcy Act] were intended to give strength to the Official Creditors Committee by arming it with paid attorneys and accountants to assure that it can effectively represent the interests of *all* creditors and *all classes* of creditors . . ." (Emphasis supplied)

It is precisely because the Official Committee in this instance did ***not*** effectively represent *all* classes of creditors (in particular the public debentureholders) that counsel for the Indenture Trustee was forced to step in.

that it is determinative of the issue presented on this appeal, must clearly be inferred as favoring compensating counsel for the Indenture Trustee in the situation presented by this proceeding.

Second, counsel for the Debtor-Appellee relies heavily on the case of *Lane* v. *Haytian Corporation of America*, 117 F.2d 216 (2nd Cir.), cert. den. 313 U.S. 580 (1941) (the "Lane case") as alleged support for its view that in a Chapter XI proceeding the Bankruptcy Court is without power to award compensation to counsel for an Indenture Trustee representing public debentureholders. Reference to the Lane case is made no less than six times in Appellee's Brief, it being contended that the refusal to allow compensation to counsel for the "Independent Protection Committee" ("IPC") in that case mandates disallowance of compensation here since, according to Appellee, the I.P.C.'s function in the *Lane* case was "essentially the same as that of an indenture trustee" (Brief, p. 9).

It was pointed out in Appellant's Main Brief (pp. 10-11) that the *Lane* case did *not* involve the question of whether counsel for an Indenture Trustee, representing public debentureholders, could be compensated in a Chapter XI proceeding; it merely stands for the well established law that such compensation cannot be awarded to an unofficial committee of creditors in a situation where such creditors are adequately represented by the official committee. That the *Lane* holding cannot be applied to counsel for an Indenture Trustee is conclusively evident from the fact that *the attorneys for the Indenture Trustee in Lane were, in fact, compensated for their services.* Although this is not apparent from the decision of the Court of Appeals, reference to the district court opinion in that case (33 F. Supp. 171) reveals that the Referee in Bankruptcy in that Chapter XI proceeding granted allowances to three categories of counsel:

1. The attorneys for the creditors committee;

2. The attorneys for the debtor; and

3. The attorneys for the Indenture Trustee, representing public debentureholders.

The Plan of Arrangement in that case had also provided for compensation to *three* unofficial creditors' committees. The Referee denied allowance to the three unofficial creditors' committees. See *In re Haytian Corp. of America,* 33 F. Supp. 171-2 (S.D.N.Y. 1940), *rev'd* 117 F.2nd 216 (2d Cir.), *cert. denied* 313 U.S. 580 (1941).

The district court reversed the referee's decision insofar as it denied the applications for allowances by the three unofficial creditors' committees. The district court's decision with respect to the applications of the unofficial creditors' committees was, in turn, reversed by the Court of Appeals for the Second Circuit. The ultimate result of the Lane case was that allowances were granted to the attorneys for the Indenture Trustee as well as to the official creditors' committee and the attorneys for the debtor, but denied to the unofficial creditors' committees.

Thus *Lane* involved the denial of allowances only to unofficial committees of creditors. Moreover, the issue was decided in the context of an allowance having already been granted to the attorneys for the Indenture Trustee. Nothing could more clearly emphasize that the Lane case does not constitute authority for denying the application of the Indenture Trustee in the instant case.*

Third, Appellee's reliance on *Matter of Sapphire Steamship Lines, Inc.,* Docket 74-1533, January 14, 1975, reproduced as an appendix to Appellee's Brief, is similarly inapposite. The Sapphire case involved a straight bank-

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* It is noted that the official creditors' committee in *Lane* was represented by the predecessor of the same firm of attorneys representing the debtor in this case, so that the distortion of the *Lane* holding in Appellee's Brief in this case is all the more pointed.

ruptcy and not a Chapter XI proceeding. This Court quite properly held that the attorneys for a single creditor who had not been authorized by court order to represent the Bankruptcy Trustee could not be reimbursed for services rendered to the Bankruptcy Trustee even though such services enhanced the Bankrupt's estate.

Thus the cases relied upon by Appellee and by the Court below involved only the issue as to whether an allowance could be granted to counsel for an unofficial committee of creditors or individual creditors. Moreover, the Lane case was decided against the background of an allowance having been already granted to the attorneys for an Indenture Trustee, thus indicating the clear distinction between unofficial creditors' committees and Indenture Trustees with respect to the granting of allowances in Chapter XI proceedings. Far from constituting authority for denying allowance to counsel for an Indenture Trustee, the Lane case supports such an allowance as a matter of course.

The uncontested allowance granted to the Indenture Trustee in *Lane* undermines the arguments set forth in all three points of Appellee's Brief. The fact that Congress, in enacting amendments to the Bankruptcy Law, did not specifically provide for compensation to Indenture Trustees should be considered to mean that Congress saw no reason to do so, since the *Lane* case constituted authority that such compensation was to be awarded as a matter of course. It is therefore not reasonable to draw the inference which the Debtor suggests, namely, that by its failure to include provisions covering Indenture Trustees in the Chapter XI rules Congress somehow indicated its intent that Indenture Trustees should not be compensated in Chapter XI proceedings. At the time the rules were adopted, there was no reported case authority for denying compensation and expenses to Indenture Trustees in Chapter XI proceedings. Accordingly, it is not reasonable to infer that Congress intended that the newly adopted Chapter XI rules should be construed to affect this issue—which had not been raised

and of which Congress cannot be presumed to have been aware—one way or the other. The fact that Congress did not expressly *prohibit* such compensation is more significant since it mandates the inference that Congress was satisfied with the decision in the *Lane* case in which compensation to the Indenture Trustee had been allowed.

Moreover, the Indenture under which an Indenture Trustee acts is largely the product of the Trust Indenture Act enacted by Congress in 1939, subsequent to the enactment of the Chandler Act which created Chapter XI. The Indenture contains provisions for the protection of the public debentureholders which were dictated by Congress. These provisions impose unique responsibilities on an Indenture Trustee. Thus upon the occurrence of an event of default, including the failure to pay interest and the filing of a Chapter XI petition, the Indenture Trustee is specifically empowered by the Indenture to take an active role to protect the interests of the Debentureholders,

> and to do and perform any and all such acts and things for and on behalf of such holders of the Debentures as may be necessary or advisable in the opinion of the Trustee in order to have the respective claims of the Trustee and of the holders of the Debentures against the Company or its property allowed in any such proceeding, and to receive payment of or on account of such claims; . . . .
>
> Section 7.02

This standard of conduct is specifically required by Section 315(c) of the Trust Indenture Act, which provides as follows:

> The indenture to be qualified shall contain provisions requiring the indenture trustee to exercise in case of default (as such term is defined in such indenture) such of the rights and powers vested in it by such indenture, and to use the same degree of care and skill in their

> exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.

The Indenture also contains the customary provisions requiring the Company to indemnify the Indenture Trustee for any expense incurred in carrying out its obligations under the Indenture, and further provides (Section 8.06):

> . . . The obligations of the Company under this Section to compensate and indemnify the Trustee and to pay or reimburse the Trustee for expenses, disbursements and advances shall constitute additional indebtedness hereunder and shall survive the satisfaction and discharge of this indenture. Such additional indebtedness shall be secured by a lien prior to that of the Debentures upon all property and funds held or collected by the Trustee as such, except funds held in Trust for the benefit of the holders of particular Debentures.

Thus the Indenture Trustee has been required by express provisions of the Indenture, mandated by Federal Statute, to take certain actions on behalf of the Debentureholders during the subject Chapter XI proceeding on condition that it be compensated by the Company. It is against basic principle of fairness and equity to impose such responsibilities on the Indenture Trustee without providing for its just compensation, and Appellee has failed to cite any authority for the proposition that Congress intended Indenture Trustees and their counsel to undertake the responsibility of representing public debtholders of Chapter XI companies gratis.

In recognition of the special obligations of an Indenture Trustee during a bankruptcy proceeding, Congress has directed that in reorganization proceedings under Chapter X of the Act and in railroad reorganizations under § 77 of the Act an Indenture Trustee be paid compensation for its services and reimbursement for its expenses. To hold that an Indenture Trustee may not be paid in a Chapter XI pro-

ceeding for the very same services for which it would be paid in a Chapter X proceeding would be anomalous. Moreover, if compensation is not paid to Indenture Trustees in Chapter XI proceedings, such Indenture Trustees would have less incentive during such proceedings to represent their debentureholders, the precise group the SEC has indicated its concern for in this proceeding. Rather, it would create an incentive for Indenture Trustees, to the possible detriment of their debentureholders, to favor proceedings in the much more costly Chapter X rather than Chapter XI. This would put the Indenture Trustee in the uncomfortable and conflicting position of attempting to carry out its obligations under the Indenture to represent the best interests of the debentureholders despite the prospect of not being compensated in one of the two alternative bankruptcy proceedings. Realistically, if compensation cannot be paid to Indenture Trustees in Chapter XI proceedings, such Indenture Trustees have no alternative but to move under § 328 of the Bankruptcy Act for an order dismissing the proceeding unless the petition be amended to comply with Chapter X.

Appellee argues that the absence of a provision in Chapter XI compensating Indenture Trustees indicates an intent by Congress that Indenture Trustees should make such a motion under § 328. Yet Appellee vigorously fought against the Regional Administrator of the Securities and Exchange Commission who proposed to make such a motion in this proceeding, and solicited the aid of Appellant in opposing such a move.

Conclusion

All of Appellee's arguments avoid the simple question involved on this appeal,—whether public debentureholders wholly excluded from the Official Creditors Committee and all of its deliberations and negotiations with the Debtor, and unprotected by the SEC, should be left to the tender mercies of the "Official Creditors Committee" and the Debtor, both of whom originally took the position that such debenture-

holders should receive no share in the Plan of Arrangement or whether they should be placed on a parity with "official" creditors by allowing payment for their representation through an Indenture Trustee?

For the foregoing reasons, and the reasons set forth in the Main Brief of the Appellant, it is respectfully submitted that the application of the United States Trust Company of New York, as Successor Indenture Trustee, for an allowance should be granted.

Respectfully submitted,

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